PDTBJ 744

THE DPM PILOT PROGI
FOR HUNGARIAN SAVII
COOPERATIVES

FINAL REPORT

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ABSTRACT

The attached is a final report for RFS 554 - DPM Pilot Program. The report covers work by DPM and Marketing Advisors from Fannie Mae, with staff from four of the Hungarian Savings Cooperatives.

The advisors worked with representative of Takarékbank and the National Federation of Savings Cooperatives (OTSZ)—the training arm of Takarékbank—to develop a plan to provide the Hungarian Savings Cooperatives that are members of the federation with the education and training they need to be able to offer their customers the Deferred Payment Mortgage.

A pilot program for the DPM was also carried out in four savings cooperatives. These cooperatives were chosen to represent a variety of geographical areas and economic conditions. During the pilot, each cooperative was visited, and the loan product was introduced and discussed. During the discussion, the staff of each cooperative was encouraged to identify any concerns and impediments that would affect offering this product to their customers. The results of these discussions will be incorporated into the formal training given in the fall.

EXECUTIVE SUMMARY

Two advisors from Fannie Mae, a DPM Advisor and a Marketing Advisor, visited Hungary in May 1997 to lay the groundwork for the introduction of the DPM loan product to the members of the Hungarian Savings Cooperatives.

Four cooperatives were chosen as sites for the pilot, to provide geographic and economic variety. These four, Veresegyháza, Mór, Barcs and Ják were visited by the DPM advisor who explained the product features, accounting aspects, customer base, and software for servicing. Lengthy discussions of unusual aspects of the loan product, including the negative amortization, took place, and the advisor demonstrated the performance of the loan over time with the use of an Excel spreadsheet.

Cooperative staff members were encouraged to identify any aspects of marketing the loan that would be difficult for them, or features of the loan that would be hard to explain to their customers. The Advisor collected information on four major areas of concern: delivery of the software, matching the maturities of funds and loans, investing reserves, marketing materials. This report includes summary information about these issues and each of the cooperatives.

The Marketing Advisor worked with Takarékbank and the National Federation of Savings Cooperatives (OTSZ)—the training arm of Takarékbank—to develop a plan for the cooperatives for the education and training needed to offer the DPM to their customers. The focus was challenges that offering the DPM poses for the savings cooperatives and how the training might help the cooperatives to address those challenges.

A training plan was drafted, reviewed with representatives of OTSZ and Takarékbank, and then finalized. The final version is provided in this document. This report also contains a synopsis of the meetings attended by the Marketing Advisor, and a summary of the meetings attended by the DPM Advisor.

THE DPM PILOT PROGRAM FOR HUNGARIAN SAVINGS COOPERATIVES

FINAL REPORT

DPM TRAINING PLAN

This training plan outlines the approach that Takarékbank and the National Federation of Savings Cooperatives (OTSZ) propose to take to provide the savings cooperatives that belong to the federation with training that would enable them to offer their customers the Deferred Payment Mortgage (DPM). This approach would provide DPM training to the savings cooperatives in four phases: nationally, regionally, locally, and individually. Each phase is described in greater detail below.

Phase One: National Training

A nationally-offered 2-day training session, held in Budapest in July, would constitute the first phase of DPM training for the savings cooperatives.

Takarékbank and OTSZ would invite a representative from a "lead" savings cooperative from each of Hungary's 18 geographic regions and from each of the cooperatives that have been identified by Takarékbank as highly likely to be among the first to offer the DPM. (We refer to these cooperatives as "pilot" cooperatives.) Attendance would be limited to approximately 25.

The training session would provide attendees with an in-depth understanding of the DPM product, its features and benefits, and how to originate, underwrite, and service the product. It would also provide them with tools and training that would enable them to replicate the training session on a regional basis.

Takarékbank and OTSZ would select the instructor(s) for Phase One training from the "pilot" cooperatives. They would select instructors on the basis of their understanding of the product, their enthusiasm for the product, and their ability to communicate both with confidence and credibility.

OTSZ would extend invitations to attendees and instructor(s), make all of the logistical arrangements, and pay for duplication of materials and instructors' fees.

Fannie Mae would design the training session and develop the instructor's guide and participants' materials. Takarékbank and OTSZ would provide input, review, and approve the course design and materials.

Phase Two: Regional Training

Participants in the Phase One training in Budapest would serve as instructors for the Phase Two training and would essentially replicate the nationally-offered training session on a regional basis during August, 1997.

Attendees at each of the Phase Two training sessions would be drawn from savings cooperatives in the region in which the training session was being offered.

The regional training sessions, like the national training session, would provide attendees with an in-depth understanding of the features and benefits of the DPM, and would provide them with the information and skills required to originate, underwrite, and service the DPM. The training sessions would also prepare attendees to go back to their own cooperatives and conduct DPM training sessions for their own employees.

OTSZ would extend invitations to attendees, make all of the logistical arrangements, and pay for duplication of materials and instructors' fees.

Phase Three: Local Training

Participants in the Phase Two training sessions would serve as instructors for the Phase Three training sessions. Again, they would replicate the nationally-offered training session, this time for the staffs of their own cooperatives. Phase Three training would take place during September, 1997.

The goal of the Phase Three training sessions would be the same as Phases One and Two. It is understood, however, that these training sessions would need be customized to meet the needs of each individual cooperative and the customers they serve.

Each cooperative would make separate logistical arrangements.

Phase Four: Individual Training

Phase Four DPM training would consist of a series of independent study modules—each covering one of the major topics addressed in the classroom training.

The modules would be designed for savings cooperative staff who were unable to attend a classroom training session, or for those who were able to attend a training session but would like an on-the-job reference tool.

Fannie Mae would develop the independent study modules. Takarékbank and OTSZ would provide input, review, and approve the content of the modules and would be responsible for duplication and distribution of the modules.

The modules would be made available on a staggered basis as they were completed. All of the modules would be available by year-end.

The biggest hurdle that needs to be overcome in order for the savings cooperatives to offer the DPM is not the lack of information, or training, or software—although these are all issues that need to be addressed—rather, it is the lack of motivation. The training sessions that we design need to address the motivation issue head on. The cooperatives themselves need to be "sold" on the product and all that that implies in order to make the changes within their own organizations that will be required in order to offer the product and to sell it to their own customers.

MEETING SUMMARY

Monday
May 5, 1997
Takarékbank
11:00 a.m. - 2:00 p.m.

Attendees:

Istvan Varga, Takarékbank
Karoly Nemes, Takarékbank
Aranka Tihanyi, National Federation of Savings Cooperatives (OTSZ)
Katie Mark, Urban Institute
Erika Farkas, Metropolitan Research Institute
Julie Lazar, Fannie Mae
Gabriella Szabo, Interpreter

**Mr. Dobos came in briefly at the end of the meeting.

Highlights:

Mr. Nemes, who is the head of the DPM committee at Takarékbank, stated that the major impediment to rolling out the DPM is getting software developed that would enable the savings cooperatives to service a negative amortization loan like the DPM. By the end of the meeting, Mr. Nemes made a tentative commitment to having the software developed by the end of June.

Tuesday
May 6, 1997
Veresegyháza Savings Cooperative
9:00 a.m. - 4:00 p.m.

Attendees:

Janos Radi, President, Veresegyháza Savings Cooperative
Marta Kovacs, Branch Manager, Veresegyháza Savings Cooperative
Aranka Tihanyi, National Federation of Savings Cooperatives (OTSZ)
Erika Farkas, Metropolitan Research Institute
Julie Lazar, Fannie Mae
Gabriella Szabo, Interpreter

Highlights:

Mr. Radi made presentation about the savings cooperative—who they are and what they do. Mrs. Farkas provided an overview of the DPM product. And, Ms. Lazar presented the DPM Excel Spreadsheet to Mrs. Kovacs.

Mr. Radi and Mrs. Kovacs expressed similar sentiments to those expressed by Mr. Nemes on the previous day, namely, that without the software to service the DPM they felt it was not possible for them to offer a loan of this complexity. They also expressed concern about the issue of matching maturities.

Wednesday
May 7, 1997
National Federation of Savings Cooperatives (OTSZ)

Attendees:

Aranka Tihanyi, National Federation of Savings Cooperatives (OTSZ)
Julie Lazar, Fannie Mae
Gabriella Szabo, Interpreter

Highlights:

Mrs. Tihanyi provided an overview of the National Federation of Savings Cooperatives, including the training that the OTSZ now offers the savings cooperatives on a regional basis. At one point, it had been suggested that the DPM training be incorporated into one of these sessions, but in this meeting Mrs. Tihanyi said she thought the DPM warranted its own training session. She did, however, suggest that we spend some time in the training session presenting new products being designed by Takarekbank. She felt that broadening the scope of the training would make the session more attractive to cooperatives.

Mrs. Tihanyi explained that the broad-based education of the savings cooperatives on the DPM had already begun. She cited the article on the features and benefits of the DPM written by Mr. Nemes that appeared in the most recent edition of the savings cooperatives' newspaper, Videk Bankja; the DPM origination and servicing procedures document; the accounting rules document; and the DPM Excel spreadsheet "demo."

With all of these explanatory materials in place, Dr. Tihanyi proposed that Takarekbank and OTSZ organize a one-day training session in Budapest this summer. The training session would focus on the DPM, but would also introduce several new consumer products being developed by Takarekbank's Product Development Committee. OTSZ would invite representatives from each of the 231 savings cooperatives that belong to the federation. Dr. Tihanyi expected that 70 to 80 percent of the savings cooperatives would send representatives, which means there would be 175 - 200 people in attendance. She proposed that Takarekbank identify instructors for the training session who would then be formally invited by OTSZ. OTSZ would pay the instructors' fees. All of the logistical arrangements would be handled by OTSZ.

Friday
May 9, 1997
Takarékbank

Attendees:

Andras Dobos, Takarékbank
Karoly Nemes, Takarékbank
Katie Mark, Urban Institute
Aniko Szabo, Interpreter

Summary:

During this meeting Mrs. Tihanyi's ideas on how the DPM training should be offered were presented. Mr. Dobos presented an alternative plan that incorporated some of Mrs. Tihanyi's ideas and expanded on them. At the end of this meeting, everyone committed to this plan, although it should be noted that Mrs. Tihanyi was not in attendance to "buy off" on this new plan.

THE DPM PILOT PROGRAM

The purpose of this section of the report is to summarize the findings of visits to the four savings cooperatives participating in the pilot program, Veresegyháza, Mór, Barcs and Ják. The next section provides more detail on the individual coop visits. The visits initiating the pilot program were successful in providing more detailed information to the coops about the DPM and identifying the issues that are of concern to the coops. Now that the issues have been identified, they can be addressed before the DPM is introduced to the rest of the coops, making the roll-out much smoother. The four coops have already received letters addressing these issues and providing solutions to their problems.

The coops visited were already familiar with the basic structure of the DPM. During the visits, we were able to give further explanations about the performance of the DPM in an inflationary environment. This is important for the coops to understand, mainly because of their reluctance to offer a loan with such large growth in the principal in nominal terms. Related to this, we were also able to discuss in more detail the interaction of the contract and payment rates.

Most importantly, the visits with the coops gave us a great deal of information about issues that could possibly impede their offering the DPM. These fall into four categories.

Issue	Resolution
Delivery of DPM software	Convinced coops to use Excel spreadsheet until software is completed. Provided software suppliers with all necessary materials.
Matching maturities of funding and loans	Explained that short term deposits count as long term funding if it can be shown that they are continually rolled over.
Investing reserves	Explained that reserves can be held in government paper. Accounting issue only.
Availability of marketing materials	Materials are complete and ready to be distributed to coops for comments.

The first issue is the delivery of the DPM software. There is a definite reluctance on the part of some coops to offer the DPM without the software, partially because of the DPM calculations and partially because of a reluctance to enter activity into the General Ledger manually. The advisor was able to convince the coops to offer the DPM using the Excel spreadsheet, on the grounds that there will be only a few months of calculating, on only a few loans, before the software becomes available. Also, in order to facilitate the delivery of the software, a meeting was held with the software vendors who stated that they have all of the information on the calculations and accounting issues that they needed. In fact, they were very impressed with the thorough explanations of the accounting issues.

The second issue of concern to the coops is the matching of maturities of funding and loans. At one time there was a guideline of the MNB that the maturities of the two had to match. Since most deposits are short-term, that would make it almost impossible to offer a long-term mortgage like the DPM, which should be at least a 10-year mortgage. However, it was determined that the law has since been revised to read that the funding should match "appropriately" which can be more loosely interpreted. In fact, the way this is handled by some of the coops (and should be by the rest) is that as long as the funding (deposits) are continually rolled over, they are considered to be long-term funding. This was pointed out to the coops in the letters. This is an acceptable short-term solution, however, it is critical to design a comprehensive asset liability management program for the coops, perhaps with the help of OTIVA. Although liquidity itself is currently not an issue, there is so much potential for interest rate volatility that this issue should be addressed, preferably before it becomes a problem.

The third issue is the problem of the large reserves the coops are required to hold for the DPM. The coops are concerned that if they had to hold reserves in cash in the amount of the original principal plus the capitalized interest, they would earn a significantly lower profit on the DPM loans they made. However, after investigation, it was found that reserves can be held in government paper which is considered to be sufficiently liquid for such a purpose. As the coops already invest a lot of their funds in government paper, this is no disadvantage to them at all. This solution also was pointed out to the coops in the letters. However, later on Erika Farkas found out that the entire reserves issue is really an accounting issue and no money is actually put aside or invested. The reason that capitalized interest is reserved against is that, according to accounting principles, if capitalized interest is reserved against, it is not taxable as income. Therefore, it is an advantage to the coops offering the DPM and not a constraint. Because of all the confusion surrounding this issue, Erika Farkas will investigate further and once it is clarified, complete information will be included in the training.

The fourth issue that was discussed during the visits is the coops' interest in marketing materials. Work that has been completed on marketing brochures was presented and this is ready for their review. It would be very useful to get feedback on the marketing brochures from the four coops once the editing and translating are finished. Included in the discussion was OTSZ's possible role in printing the brochures and then charging the coops who purchase them.

The training plan for DPM is also in the process of being designed, and training materials will be ready when the software is completed so that training can begin immediately. When an outline of the training plan is completed, it should be distributed to the four coops for their review for their comments.

In order to maintain the working relationships with these coops that will ensure the success of the pilot program, the advisors plan to stay in close contact with them. They encouraged them to discuss any further concerns or problems with us. They would also like to get their comments on the marketing brochures and training plan and have discussed this with Erika Farkas. Insights from these coops will be valuable in making both of these as effective as possible, and it will also keep these four coops involved in the pilot program. The advisors have also discussed staying in contact with them with one or two "mini surveys" to learn how the program is progressing, and whether the coops are encountering any problems that they can help them to resolve. As the pilot program progresses, they can continue to resolve these issues and others that come up.

The following information presents a detailed discussion of the issues identified by each cooperative relative to offering the DPM. The issues are believed to be representative of the issues other coops would face. This section also includes a brief summary of the discussion concerning software development in a meeting with four software vendors

Veresegyháza Savings Cooperative

This coop is located north of Budapest within commuting distance of the city. Because the area is growing rapidly as a commuter suburb, the coop has been experiencing growth also. The balance sheet has tripled in the last five years. There are currently seven branches and they are planning to open an eighth one. There are approximately 19,500 members, 17,000 depositors and HUF 1.7 billion in deposits. In 1996, 51 housing loans were made for a total amount of HUF 22 million. Over half of these were annuity loans at market rates. Of the remainder, approximately half were interest subsidized (4,3,1 subsidy) and the rest had new construction subsidies.

The president of the coop and the branch manager of the largest branch stated that they are very much in favor of offering the DPM. They believe that the rapid economic growth in the area and the amount of new construction will provide many opportunities to offer the loan. Unfortunately, they are also extremely reluctant to offer the DPM until they have the software. They believe that even if they could do the calculations on the Excel spreadsheet or the DPM demo, they could not make the general ledger entries manually. In the letter sent to the coop before the end of the visit, Erika and the DPM Advisor strongly encouraged them to reconsider their decision and to offer the DPM before the software became available. Because of the same volume anticipated, only a few loans would require entries and this would be needed only for only a few months since the software should be available soon.

The second issue that is an obstacle to offering the DPM is the necessity of matching the maturities of deposits to the maturities of loans. The president believes that, based on the regulations, the maturities must match exactly whereas deposits are almost all short-term (depositors are unlikely to be willing to commit their money for longer terms because the recent economic turmoil has left them apprehensive). The DPM should have a term of at least 10 years. Currently, housing loans have terms of five years at the most.

The advisor investigated this issue and found that recent regulation did require that maturities must match. However, now it states only that the maturities of deposits and loans must match "appropriately" which leaves room for interpretation. She also discovered that if a coop can show that the deposits are continually renewed, they can be considered long-term funding. The Veresegyháza coop was the only coop focused on this as a major issue, although it was also mentioned at the other coops when the longer term of the DPM was discussed. Aranka Tihanyi from OTSZ stated that different examiners interpret things differently and it is possible that the examiner with whom this coop deals may require them to comply to this regulation more strictly than most.

In the letter to Veresegyháza, the DPM Advisor informed them of the new, more flexible regulation, and of the fact that as long as the deposits were renewed they could be considered long-term funding.

Mór Savings Cooperative

Like Veresegyháza, Mór Savings Cooperative is also located in a region of Hungary that has experienced fairly strong economic growth compared to the rest of the country. The coop has 11 branches. Total loans outstanding increased during 1996 from HUF 392 million to HUF 449 million, a growth rate of approximately 15 percent. Housing loans totaled HUF 113 at the end of 1996, down from HUF 121 at the beginning of the year. Most of the growth in outstanding loans came from consumer loans.

The president and chief accountant are extremely interested in offering the DPM. They believe that there is large potential demand for the DPM, especially once the economy gained strength (which they were optimistic about). They are interested in receiving marketing materials in order to begin marketing the DPM.

The two issues that they consider obstacles to offering the DPM are software development and reserve requirements. Like Veresegyháza, they do not want to offer the DPM until the software is available. Also, they are concerned about the delivery of the software because they believe that the software vendors were not motivated to start the development because they did not approve of the product. In their opinion, Takinfo is not doing their part in working with the five software vendors. The cost also seems prohibitive and they are not sure at this point whether Takinfo would bargain to lower the price for the coops.

The DPM Advisor encouraged them to offer the DPM without the software, by using the Excel spreadsheet. After showing them how it worked, they seemed willing to do so, except for the fact that they had Excel only in the headquarters and they were afraid that they may break copyright laws by using it for loans originated in branches. In a follow-up letter, the advisor explained that the cost of additional Excel packages was fairly low and that they could add them to the branches slowly, as customers showed an interest in getting a DPM loan.

Their second main concern is that the reserve requirements for the DPM would be so high—the entire amount of principal and the capitalized interest—that it would reduce the profitability to the coop significantly. The advisor investigated this issue and found that only the capitalized interest has to be reserved against and that the coops can hold the reserves in government paper which is considered sufficiently liquid for this purpose. It has little or no effect on profitability since the coops hold most of their funds in government paper due to the low demand for loans, caused by the poor economic conditions. They were informed of these findings in a letter. However, Erika Farkas learned later that the entire reserves issue is really an accounting issue and no money is actually put aside or invested. The reason that capitalized interest is reserved against is that, according to accounting principals, if capitalized interest is reserved against, it is not taxable as income. Therefore, it is an advantage to the coops offering the DPM and not a constraint. Because of all the confusion surrounding this issue, Erika will investigate further and once it is clarified, the results will be included in the training.

This coop has the potential to be very successful in offering the DPM. The region of operation has a relatively strong economy with potential for more growth. In addition, the president and chief accountant have a very proactive, optimistic approach as shown by their interest in actively marketing the DPM. They also have a very capitalist-type interest in profit, as shown by their attitude toward reserve requirements.

Other interesting issues discussed were the acquisition of Takarekbank by Deutsche Genossenschafts bank and the new housing savings plan that replaced the youth savings plan.

Barcs Savings Cooperative

This is the only savings coop that actually offered DPM loans completely independently a couple of years ago. They made three or four DPMs which have now switched to regular annuity loans because the borrowers received subsidies that paid the loan balance down to the point at which positive amortization begins.

Barcs is located in a rural area near the Croatian border. The economy in the region is weak. There have been numerous lay-offs by all the major employers in the area, such as building materials producers and a chemical factory. As a result of the weak economy, loan demand is also weak. Of deposits, only 30 percent is lent out and the remaining 70 percent is invested in government paper. Two years ago, 70 percent of available funds were in loans because the coop was heavily involved in making car loans. There was a Renault dealer in the area with whom they did business but shortly before the dealer declared bankruptcy, the coop became suspicious of its financial activities and suspended its loan program. Of an original balance of outstanding loans of approximately HUF 130 million, half a million is still outstanding.

In addition, the coop is heavily involved in foreign exchange. Because of its location on the Croatian border, there is a lot of demand for foreign exchange in Croatian, German, and US currency (because of IFOR).

The coop has eight branches. There are 1,080 loans outstanding for a total of HUF 209 million. Of this, 20-25 percent are housing related loans. Approximately half of the housing loans are subsidized new construction loans, one-quarter have no subsidies and the rest are loans with interest rate subsidies, DPMs, or other types of housing loans.

This coop obviously is not concerned with obstacles to offering the DPM since they had made such loans in the past. Their main problem is with the state of the local economy, which keeps demand for loans low. They are interested in obtaining marketing materials so they could actively market the DPM because they believe in the advantages it offers to borrowers in an inflationary environment, especially for borrowers who can take advantage of subsidies. They also hope that the software development is progressing, because they prefer offering the DPM with the software.

Ják Savings Cooperative

For more information about Ják coop, please see previous reports.

Ják is a profitable coop located in a region with strong economy. Unemployment is low and many people are moving here from eastern Hungary and Transylvania. Also, people are moving out of Szombathely—the largest city in the area—to the surrounding villages. Because this area borders on the West, during communism, development here was discouraged. Now for this same reason, its proximity to the affluent West, especially Austria, there is a great deal of economic activity. There is plenty of opportunity for building and therefore good potential for loan demand.

The president and chief accountant expressed an interest in obtaining marketing materials. The possibility of printing them up with the help of OTSZ was discussed. OTSZ would charge coops for purchasing the brochures.

There is a definite reluctance to offer the DPM without software, but when pushed on the issue, they said that they would offer it using the Excel spreadsheet until the software became available.

The reserve requirements were discussed at length because of the confusion surrounding the issue. There was a misconception that the entire principal, including the original principal and the capitalized interest had to be reserved against. Again, it was clarified that only the capitalized interest has to be reserved against. As explained above, this is really an accounting issue and no money is actually set aside.

This coop has the potential to be very successful in offering the DPM. They are located in an area with good potential for demand and the coop is strong and profit-oriented.

Software Vendor Meeting

The meeting was set up to expedite the delivery of the DPM software, which had been delayed several times. The completion of the software is critical for the success of DPM because many of the coops in the pilot program expressed hesitation in offering the product until they had the software.

The meeting was attended by at least one representative from each of the major software vendors used by the coops: Progadat, Optisoft, Orient, and Montana. Also present were several staff members from Takinfo, Károly Nemes, Anita Farkas who prepared the accounting rules, and Erika Farkas. The tone of the meeting was very contentious. It appeared that the software vendors felt that they were being blamed for the late delivery date of the software, and they in turn blamed Takinfo for refusing to write a contract for them until the Giro software was completed. They felt that until they had a contract, it would be foolish to even start to assign resources to the project. There was also some confusion about the cost of the software. There was a lengthy discussion at one point about whether it would be included in the price of the Giro software but it was by no means clear what the final decision on price would be.

The most positive aspect of the meeting was that the software vendors informed us that they had everything they needed in terms of specifications. They all agreed that the accounting rules they had received with the various scenarios were excellent and that they had enough information to begin programming. Copies of the Demo spreadsheet were distributed, together with a simpler spreadsheet more focused on the mechanics of the DPM itself.

LETTERS TO PILOT COOPERATIVES

Letter to János Rádi, Veresegyháza Savings Coop

May 21, 1997

We are pleased that we had the opportunity to meet with you to discuss the DPM and your participation in the pilot program. In order to ensure the success of the pilot program, it is important for us to understand any obstacles you foresee to offering the DPM.

The obstacles seem to be the lack of software, the proper procedure for the matching of maturities of loans and funding, and the lack of marketing materials. Until the software is ready we encourage you to offer the DPM using the Excel spreadsheet.

We have prepared marketing materials and after they have been translated, we would like to get your comments on them. OTSZ will be involved in the printing and distributing the brochures to the savings coops. We will let you know the procedure when it has been worked out.

We will find out from OTIVA and MNB what the policy for matching maturities of funding and loans is. So far, we have found out that as long as it can be proved that deposits are continually renewed, they are considered long term funding and therefore can be used to fund a long term mortgage such as the DPM.

Please let us know if there is anything else we can help with.

Letter to Ilona Hoffman and Ildikó Korb, Mór Savings Coop

May 21, 1997

We are pleased that we had the opportunity to meet with you to discuss the DPM and your participation in the pilot program. In order to ensure the success of the pilot program, it is important for us to understand any obstacles you foresee to offering the DPM.

One of the obstacles seem to be the lack of software. We will do whatever we can to expedite the completion of the software and until then encourage you to offer the DPM using the Excel spreadsheet.

We will find out from OTIVA and MNB what the policy for matching maturities of funding and loans is. So far, we have found out that as long as it can be proved that deposits are continually renewed, they are considered long term funding and therefore can be used to fund a long term mortgage such as the DPM.

As far as the reserve requirements are concerned, we will find out whether or not OTP received an exemption from the law and we will work towards obtaining the same exemption for the savings coops. In the meantime, we have found out that reserves can be held in government paper which is considered sufficiently liquid and which the coops already hold.

We are working on marketing materials that will better explain the DPM to customers.

Please let us know if there is anything else we can help with.

Letter to Mr. Bakonyi, Barcs Savings Coop

May 21, 1997

It was a pleasure to meet with you to discuss the DPM and the pilot program. I would like to repeat that I was very impressed that you offered a complicated loan such as the DPM before any of the other savings coops. I am certain that during the pilot program you will be able to offer more DPMs in spite of the slow economy.

I think I can be of the greatest help to you in offering the DPM by providing you with marketing materials. We are working on brochures that will better explain the DPM to your customers.

We also plan to discuss the proper procedure for matching maturities of funding and loans with OTIVA and MNB.

Please let us know if there is anything else we can help with. (Contact Erika Farkas with whom I will be in contact.)

Letter to Lajos Németh and Tibor Szabados, Ják Savings Coop

May 21, 1997

We are pleased that we had the opportunity to meet with you to discuss the DPM and your participation in the pilot program. In order to ensure the success of the pilot program, it is important for us to understand any obstacles you foresee to offering the DPM.

It seems to us that the lack of marketing materials is an obstacle to offering the DPM. We have prepared marketing materials and when they are translated, we will send you a copy. It would be very useful to us to get your comments on the marketing brochures. We will let you know the final details of how the printing and distribution of the brochures will work and what OTSZ's role will be.

Please let us know if there is anything else we can help with.

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MEETINGS IN HUNGARY: MAY 5 - 23, 1997

Date	Location	Participants	Purpose
May 5, 1997	Budapest Marriott	Katie Mark, Erika Farkas, Margaret Grady, Julie Lazar	Background briefing and project agenda
May 5, 1997	Takarékbank	István Varga, Károly Nemes, András Dobos-TKB, Aranka Tihanyi-OTSZ, Katie Mark, Erika Farkas, Gabriella Szabó, Margaret Grady, Julie Lazar	Discuss expectations from pilot program and software delivery difficulties
May 6, 1997	Fót branch of Veresegyháza coop	János Rádi-President, Márta Kovács-Fót Branch Manager, Aranka Tihanyi, Erika Farkas, Gabriella Szabó, Margaret Grady, Julie Lazar	Present DPM demo and discuss pilot program and coop operations
May 7, 1997	OTSZ	Aranka Tihanyi, Gabriella Szabó, Margaret Grady, Julie Lazar	OTSZ functions, role in training
May 9, 1997	Mór coop	Ilona Hoffman-President, Ildikó Korb-Chief Accountant, Aranka Tihanyi, Gabriella Szabó, Julie Lazar	Present DPM demo and discuss pilot program and coop operations
May 9, 1997	Takarékbank	András Dobos, Károly Nemes, Katie Mark, Margaret Grady, Interpreter	Reviewed training plan
May 12, 1997	Barcs coop	Mr. Bakonyi-President, Lõrinc Friedrich, Tamás Tompa and other staff members, Károly Nemes, Julie Lazar	Present DPM demo and discuss pilot program and coop operations
May 15, 1997	Ják coop	Lajos Németh, Tibor Szabados, Joli Varga, Károly Nemes, Aranka Tihanyi, Erika Farkas, Julie Lazar	Present DPM demo and discuss pilot program and coop operations
May 21, 1997	Takarékbank	Representatives from software suppliers, Takinfo, Károly Nemes, Aranka Tihanyi, Anita Farkas, Erika Farkas, Gabriella Szabó, Julie Lazar	Discuss specifications that suppliers need, timely delivery of software
May 23, 1997		Katie Mark, Erika Farkas, Julie Lazar	Wrap up

APPENDIX A

SAMPLES OF THREE PRODUCT BROCHURES

THE DEFERRED PAYMENT MORTGAGE

A NEW TYPE OF HOUSING LOAN

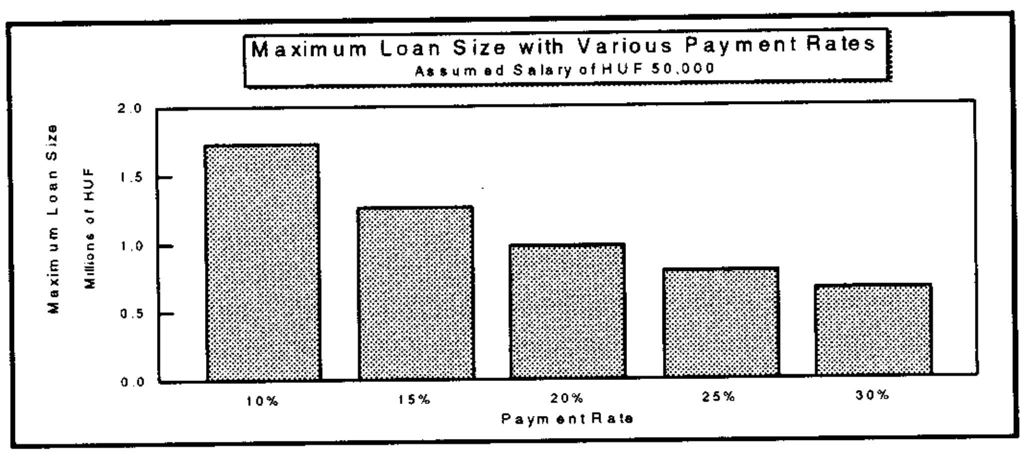
The Deferred Payment Mortgage can help you to afford a home.

When you are thinking of financing the purchase of a new home with a mortgage, it is important to find the best housing loan for you. This means a loan that meets your needs and is affordable to you.

The Deferred Payment Mortgage is offered to you by the _____ Savings Cooperative to help our customers who find that their income is not large enough to enable them to buy a house, or that the size of house they can afford is too small for their needs.

This is a new type of mortgage, suitable for the current economic period of inflation. It has many features:

— Affordable interest rate
— Larger loan amount
— Longer loan term



The Deferred Payment Mortgage is a new type of loan in many ways. By combining two types of interest rates: fixed, and adjustable, it allows you to defer part of the payment into the future, when your income is higher.

The combination of interest rates is the most important feature of this loan: your payment is calculated on a fixed interest rate, and the total amount due is calculated on an adjustable interest rate. How do these two rates work?

The interest rate used to determine your payment is calculated by the _______ Savings Cooperative. To help you afford your new home, it is set low, at a rate that is below the market rate. It will stay at the same low rate throughout the term of the loan. Because of this low rate, your payment will be less than the amount needed to repay the loan, but there is a second rate, the "contract rate" which is established at the current market rate. The difference between what your are paying, at the low payment rate, and what would ordinarily be paid, at the contract rate, is deferred and added to your loan balance. At the end of each year, the _______ Savings Cooperative will re-calculate your payment. This is necessary because the loan balance will change and the fixed payment rate will be applied to the new loan balance to determine what should be paid over the period of the next year.

In this way, although the payment rate is fixed, your payment amount will change. At the start of your loan, you will pay an amount that is based on your income—generally 30 percent—to make the loan affordable to you. Then your payments will change annually, due to changes in the loan balance.

As an example, a DAM may have a payment rate of 15 percent and a contract rate of 30 percent. After buying your house with the loan from _________ Savings Cooperative, you would repay using a payment amount calculated on the 15 percent rate every month. The difference between the 30 percent contract rate and the 15 percent payment rate will be added to the loan amount at the end of each year. This causes the loan amount to increase. Then the payment required to repay the new loan amount during the remaining term at 15 percent will be recalculated, and the payment will increase. Later during the term of the loan, the loan amount will begin to decline.

How is this loan helpful in periods of inflation? In times of price increases, wages generally keep pace with inflation. With this loan, you can borrow more money to buy the size of flat you need. Your payments will increase annually, but your income will also rise over time. This is the feature that makes the loan affordable to you. Over time, the loan amount will initially grow, and then gradually decrease.

Payment Table

Contract Rate = 30%
Payment Rate = 15%

Year	Beginning Loan Balance	Interest due at Contract Rate	Payment Due from Borrower	Interest to be Capitalized at Year-end
1	1,000,000	300,000	159,761	140,239
2	1,140,239	342,072	183,962	158,110
3	1,298,348	389,504	211,873	177,632
4	1,475,980	442,794	244,078	198,716
5	1,674,696	502,409	281,261	221,147
6	1,895,843	568,753	324,222	244,531
7	2,140,375	642,112	373,898	268,214
8	2,408,588	722,576	431,403	291,173
9	2,699,761	809,928	498,054	311,874
10	3,011,636	903,491	575,430	328,061
11	3,339,698	1,001,909	665,441	336,468
12	3,676,164	1,102,849	770,428	332,421
13	4,008,585	1,202,575	893,313	309,262
14	4,317,847	1,295,354	1,037,838	257,516
15	4,575,361	1,372,608	1,208,979	163,629
16	4,738,990	1,421,697	1,413,715	7,983
17	4,746,973	1,424,092	1,662,700	(238,608)
18	4,508,365	1,352,509	1,974,560	(622,050)
19	3,886,314	1,165,894	2,390,535	(1,224,641)
20	2,661,673	798,502	3,080,924	(2,282,422)
21	399,251	119,775	399,251	0

Advantages for You:

- This loan is more affordable than other types of housing loans
- This loan will allow you to purchase the house that accommodates the size of your family.
- This loan will help you to complete the construction or rehabilitation of your house.
- You can make additional payments at any time to pay off the loan faster.
- You can buy a new house, or an existing house.

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This loan may not be suitable for you if:

- You expect your income to increase at a much slower rate than inflation.
- You do not expect to keep the house for more than a few years.
- You expect to have significant expenses in the future that would not allow you to increase the amount of your loan payment on an annual basis.

The Deferred Payment Mortgage is a loan that may be suitable for you. Please ask the ____ Savings Cooperative to explain it to you.

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USING THE DEFERRED PAYMENT MORTGAGE WITH YOUR HOUSING SUBSIDIES

The Deferred Payment Mortgage is a new type of loan, offered to you by the _____ Savings Cooperative. If you are eligible for housing subsidies (specify), you will find that the Deferred Payment Mortgage loan will allow you to buy the size house you need for your family.

In an effort to expand the availability of mortgage credits and help people with average incomes to obtain a mortgage, the _____ Savings Cooperative has introduced the Deferred Payment Mortgage. One of the biggest obstacles to home ownership is having a modest income. The Deferred Payment Mortgage allows home buyers to limit the amount they pay for housing, and to gradually increase the amount, as their income rises.

If you are recently married and plan to have two or three children, this loan may be the best type of loan for you. You can obtain this loan at your current salary, and as your income grows over time, your loan payment will become more affordable. You will be able to pay part or all of your loan as you obtain the subsidies, based on your growing family. With a Youth Savings Account, you also reduce the amount you must borrow substantially.

For a young couple, this loan allows you to purchase a house that will be the right size for your future family.

The annuity loan is a long-term loan that is repaid at a steady rate in equal amounts over a pre-determined period of time. When there is high inflation, the purchasing power of these payments is eroded and the bank must increase the interest rate to keep up with the level of inflation. The Deferred Payment Mortgage was developed for an inflationary economy, because as the interest rate increases, housing loans become less affordable and fewer people are able to obtain them.

The Deferred Payment Mortgage uses a low, affordable interest rate to calculate the payment. The difference between the payment rate and the contract rate is added to the loan balance every year, and thus postponed. As your income grows and your purchasing power increases, so do your payments. In this way, you can repay the loan gradually. The table below shows how the payments work.

Payment Table

Contract Rate = 30%
Payment Rate = 15%

Year	Beginning Loan Balance	Interest due at Contract Rate	Payment Due from Borrower	Interest to be Capitalized at Year-end
1	1,000,000	300,000	159,761	140,239
2	1,140,239	342,072	183,962	158,110
3	1,298,349	389,504	211,873	177,632
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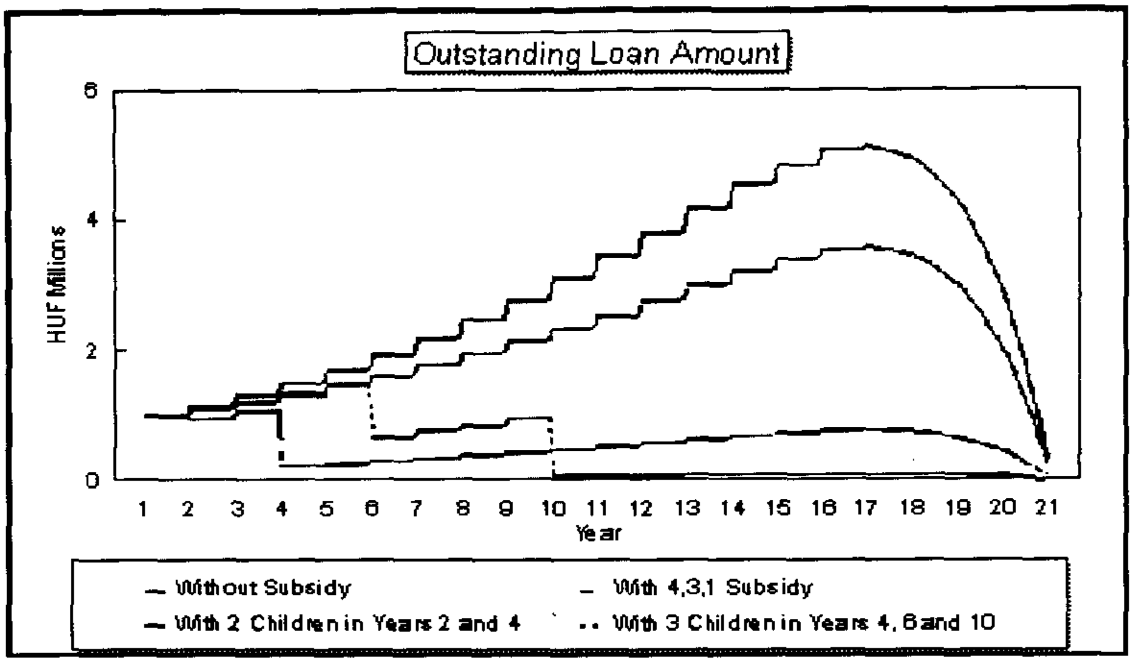
20	2,661,673	798,502	3,060,924	(2,262,422)
21	399,251	119,775	399,251	0

What Is New About this Loan?

- The amount borrowed can be greater
- The payment rate is affordable
- The term is longer
- The payments will change annually
- Additional payments can be made at any time
- This loan is available for new and existing housing

The Additional Benefit of Subsidies

The Deferred Payment Mortgage allows you to defer the repayment of part of your loan into the future. Because you plan to obtain subsidies in the future, they will pay off all or part of the loan. The payments you make before you receive the subsidies are lower, and the amount that you are deferring will be covered, partially or completely, by the subsidies. In this way, the subsidies will have a greater benefit to you, than they would if you had another type of loan. The chart below shows you how much less your balance will grow over time if you have two or three children and use your subsidies to pay off your loan. This also means that your payments will not increase either.


Outstanding Loan Amount
HUF Millions
6
4
2
0
1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18 19 20 21
Year
Without Subsidy
With 4,3,1 Subsidy
With 2 Children in Years 2 and 4
With 3 Children in Years 4, 6 and 10

THE DEFERRED PAYMENT MORTGAGE

THE AFFORDABLE HOUSING LOAN FOR YOUNG FAMILIES

The purchase of a home is one of the most important that you can make. The price is high compared to other goods, and therefore the length of time required to repay a home loan is longer than for consumer loans. Young people who are starting their career are especially affected by inflation, because their salaries are lower than they will be in the future. The Deferred Payment Mortgage lets you take advantage of your future earnings to buy a house today.

In the current inflationary economy, it has become more difficult for everyone to borrow money to purchase a home. This is because the relationship between the rate of interest that you pay and the amount that you can comfortably borrow is inverse. The higher the rate of interest, the lower the loan amount you can afford. A fundamental fact of finance is that the rate of interest determines the amount that you must repay every month, so that a 15 percent loan is "cheaper" than a 20 percent loan.

The Deferred Payment Mortgage is designed to give you the benefit of a lower rate, by postponing repayment into the future. This has two positive effects for you: a smaller, more affordable payment, and the ability to borrow a larger amount if you need it.

Payment Table

Contract Rate = 30%
Payment Rate = 15%

Year	Beginning Loan Balance	Interest due at Contract Rate	Payment Due from Borrower	*Interest* to be Capitalized at Year-end
1	1,000,000	300,000	159,761	140,239
2	1,140,239	342,072	183,962	158,110
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21	399,251	119,775	399,251	0

Many young families know that they intend to have several children, but because of their modest salaries are only able to afford a home that is suitable for one child, or no children at all. This is in spite of the fact that their salaries will grow over time, allowing them to allocate more money to housing expenses in the future. But at that time they will be living in their small home and it will be very inconvenient to buy something larger. The cost of the home will also have increased in the future, making today's prices seem cheap.

How is it possible for a young family to deal with this situation? One answer is to use the Deferred Payment Mortgage. This has just the features you need. It allows you to buy a home that is suitable for the size family you intend to have, and at the same time to afford the necessary payments.

The key feature of this loan is that you are able to defer part of your payment to the future. This is possible because the loan is calculated using two types of interest rates: fixed and adjustable. Your "payment rate" is fixed at a low rate which is less than the current market interest rate. Your payments are based on this low rate. Because this is less than the amount necessary to repay the loan, the current interest rate, the "contract rate", determines how much a full payment would be. The difference between your low payment and the full payment is deferred and added to your loan balance.

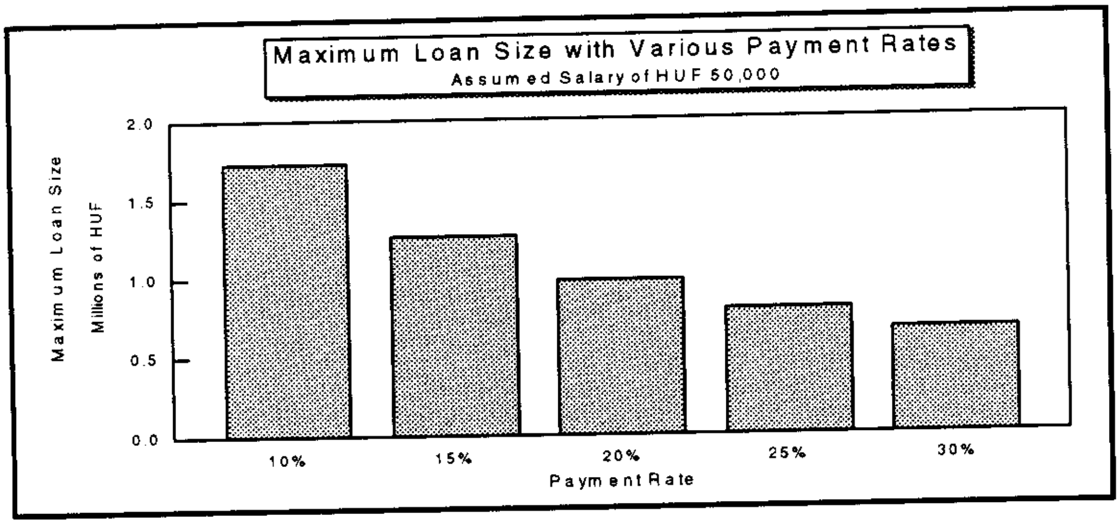
This allows you to repay part of today's payment in the future. In times of inflation, wages generally keep pace with inflation. Young people who expect their salaries to rise during the course of their careers, can be even more certain that this will be the case. Deferring part of your payment into the future will also cause your loan balance to grow for the first part of your loan term, and then decline. Every year the deferred interest is added to the loan balance and your payment is recalculated, based on the new balance. This will cause the amount you pay (not the payment rate) to change. It will increase at first, and then decline, in the same way that the loan balance changes. The table below shows how the payments work.

There is another benefit to you. With many adjustable rate loans, when the rate of inflation changes, it is possible that the payment required for your loan may change quite sharply, which could cause a hardship. With a DPM, the changes are smoothed out, over the entire term of the repayment. This provides the benefit to you of allowing you to forecast changes in your expenses in advance and plan your finances better, without any sudden shocks.

In addition to being affordable, this new type of loan is attractive because you can buy just the size of home you need.

To illustrate the difference that the Deferred Payment Mortgage can make in the amount that you would be able to borrow for your new home, we can use the following chart.

If you had an annuity loan, your payment rate would be set at today's market rate, which is close to 30 percent. An example, if you have a salary of 50,000 HUF, the maximum you would be able to borrow is less than 700,000 HUF. With a Deferred Payment Mortgage, you could qualify for a loan of over 1,200,000 HUF at a payment rate of 15 percent. By deferring more of your payment and borrowing at a payment rate of 10 percent, you could qualify for an even larger loan of approximately 1,700,000 HUF.



The Deferred Payment Mortgage allows you to defer the repayment of part of your loan into the future. Because you plan to obtain subsidies in the future, they will pay off all or part of the loan. The payments you make before you receive the subsidies are lower, and the amount that you are deferring will be covered, partially or completely, by the subsidies. In this way, the subsidies will have a greater benefit to you, than they would if you had another type of loan. Please take a copy of the brochure called "Using the Deferred Payment Mortgage with your Housing Subsidies" for more information about the substantial benefits of subsidies with this type of loan.

For those people who are eligible for subsidies, the payment rate offered by the ______ Savings Cooperative can be even lower, to as low as ___ percent.

Please ask anyone at the ______ Savings Cooperative to tell you today's low payment rate. You will be pleasantly surprised!